REFORM OF ICS REQUIRES REFORM OF BOTH INTERSTATE AND INTRASTATE ICS ELEMENTS

"[ICS reform is] not as simple as just reducing rates. We need to do so in a way that doesn't jeopardize any security concerns or drive prices down so low that providers leave or service is degraded."

Chairwoman Mignon Clyburn, July 10, 2013[1]

Consistent with the Chairwoman's admonition about the complexity of ICS reform, Pay Tel has consistently advocated in this proceeding that meaningful and lasting reform of ICS cannot be accomplished by treating only one symptom of the problem. Merely addressing one aspect of the issue—such as merely reducing interstate rates—will threaten both the harms identified by Chairwoman Clyburn—compromising security and jeopardizing the delivery of ICS itself.

In particular, any rate benchmark must be established at a level that results in aggregate compensable revenues. The Wright Petitioners have agreed that: "The rate for inmate telephone service is not 'fair' if it is so low as to cause the service provider to fail."[2] Telmate, LLC explained the dynamic at play: "FCC action on interstate rates [alone and without regard to the overall ICS call mix] could . . . have the opposite effect desired by the Commission and the Wright Petitioners by making the ICS business unprofitable and driving firms from the market. A blunt regulatory response, in other words, could kill the goose and prevent achievement of the very rehabilitative objectives the Notice contemplates from reductions in ICS prices and corresponding increases in inmate calling."[3]

Pay Tel applauds the Commission's efforts in this proceeding and sincerely hopes true, meaningful reform of the ICS industry ultimately result. That will not be possible, however, without consideration of the totality of the ICS regulatory environment, including intrastate rates. If the Commission simply lowers interstate rates to a cost-based benchmark, while leaving below-cost intrastate rate caps in place, the Commission will put ICS providers—particularly providers in jails—in an economically unsustainable position. This dynamic is accentuated in jails, where ICS costs are higher and below-cost local calls are the predominant form of calling.

[1] Remarks of Acting Chairwoman Mignon Clyburn, Inmate Calling Workshop - July 10, 2013, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2013/db0710/DOC-322109A1.pdf.

[2] Wright Petitioners' Comments at 3, WC Dkt. 12-375 (Mar. 25, 2013).

[3] *See* Telmate, LLC Comments at 10, WC Dkt. 12-375 (Mar. 25, 2013) ("Telmate Comments").

Such action would conflict with the Commission's previous approach to ICS rates,[4] and would, undeniably, violate the law. Section 276 requires that ICS providers be "fairly compensated" for each and every intrastate and interstate call. Capping interstate rates while leaving untouched below-cost intrastate rates would create a scenario in which Pay Tel would fail to recover its total costs from its aggregate revenues—a scenario in blatant contravention of federal law and Commission precedent.

I. The FCC's Current Approach to ICS Rates Forces ICS Providers in Jails to Subsidize the Cost of Local Calls Through Long Distance Rates.

Section 276 of the Communications Act of 1934 (the "Act") demands a holistic view of ICS, mandating that all payphone providers, including ICS providers,[5] be "fairly compensated *for each and every completed intrastate and interstate call* using their payphone . . . ."[6] The statute does not permit looking at interstate calls in a vacuum while ignoring intrastate calls.

The Commission itself has recognized this requirement in its previous orders. In its February 21, 2002 *Order on Remand and Notice of Proposed Rulemaking*, in considering an ICS provider coalition's request for relief from below-cost local collect calling rate caps, the Commission declined to require that every call make an identical contribution to shared and common costs, thereby necessitating a review of all calls—including local and long distance—to determine whether the fair compensation requirements of Section 276 had been met.[7] The Commission concluded:

> [T]he critical factor is that the costs must ultimately be recovered, but we will not mandate a particular method of cost recovery. Unless an ICS provider can show that (i) revenue from its interstate or intrastate calls fails to recover, for *each* of these services, both its direct costs and some contribution to common costs, or (ii) the *overall* profitability of its payphone operations is deficient because the provider fails to recover its total costs from its aggregate revenues (including both revenues from interstate and intrastate calls), then we would see no reason to conclude that the provider has not been "fairly compensated."[8]

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[4] In 2002, the Commission, in refusing to preempt below-cost intrastate rate caps, concluded that an ICS provider will not meet the "fairly compensated" requirement if it cannot recover its aggregate costs from its aggregate revenues—including intrastate revenues. *See Section I, below.*

[5] *See* 47 U.S.C. § *276*(d); Notice at ¶ 49.

[6] *See* 47 U.S.C. § 276(b)(1)(A) (emphasis added); Notice at ¶ 49.

[7] *See In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 17 FCC Rcd 3248, ¶ 23 (2002) (hereinafter "*2002 Remand Order*").

[8] *Id*.

In other words, the Commission declined to either preempt state rate caps on local collect calls, or permit ICS providers to collect an additional per-call surcharge above state rate caps, because it believed such providers would be able to cumulatively recover their costs through *both* interstate and intrastate call revenues in the *aggregate*.[9] In doing so, the Commission effectively endorsed a cost recovery mechanism where common costs are shifted to interstate calls so that interstate rates support local calls at what would otherwise be at below-cost rates.

Providers in this proceeding have acknowledged that, consistent with the FCC's 2002 Remand Order, "[i]nterstate ICS prices have for years, and increasingly so today, in effect cross-subsidized local ICS rates held below cost by state, county and municipal corrections officials."[10] As Pay Tel has explained, "intrastate rates . . . have been kept artificially low due to state rate caps."[11]

The Commission has thus intentionally fostered a system in which interstate rates might subsidize intrastate rates, the latter of which do not—on their own—"fairly compensate" ICS providers in compliance with Section 276.[12] Addressing interstate rates in isolation at this time is therefore untenable; it would undermine and throw into chaos the scheme the Commission created, in which Section 276's "fair compensation" mandate is only met thanks to this symbiotic structure wherein low intrastate rates might be offset by higher interstate charges.

II. ICS in Jails Will Not Be Sustainable If the Commission Reduces Interstate Rates to Cost-Based Levels Without Preempting Below Cost Local Rate Caps.

With long distance rates offsetting losses from the artificially low local rates, it is obvious that imposing a cap on those interstate rates, without tackling the below-cost local rates, will lead to unsustainable losses for Pay Tel and other providers, particularly in jails.[13]

The record in this proceeding clearly substantiates the higher costs to operate experienced in jails as compared to prisons. For example, Pay has demonstrated several unique aspects of ICS in jails including: (i) the heavy turnover of the inmate population which results in a greater demand for high-cost individual account set-up and greater density of phones per inmates (with resulting higher capital investment, repair cost and bandwidth demand); (ii) required integration of phone and commissary systems in jails as opposed to prisons; (iii) greater incidence of non-revenue calls in jails as compared to prisons; (iv) heavier reliance on individual account set-up as

[9] *Id*. at ¶¶ 23–24.

[10] Telmate Comments at 10.

[11] Pay Tel Reply Comments at 11 n.34, WC Dkt. 12-375 (Apr. 22, 2013).

[12] *See, e.g.*, Letter from Marcus W. Trathen, Counsel for Pay Tel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-128 (Dec. 9, 2008), at 3 n.5.

[13] *See* Pay Tel Ex Parte Presentation, July 3, 2013. *See also* Pay Tel Reply Comments at 8-12.

opposed to lower-cost debit calling in prisons; and (v) fewer calling minutes of which to spread costs as opposed to prisons.

The numbers bear this out. As demonstrated in its cost study,[14] Pay Tel's cost for collect/prepaid collect calls (including all call types: local, intraLATA, interLATA, and interstate) is $0.33/minute when including the cost of commission payments and $0.21/minute when excluding the cost of commission payments. Pay Tel's cost for debit calls is $0.31/minute when including the cost of commission payments and $0.19/minute when excluding the cost of commission payments.[15]

Several of the states in which Pay Tel provides ICS impose rate caps on local calls. For example, in North Carolina, the cost of a local collect call is capped at $1.71.[16] For an 11-minute call (which is currently Pay Tel's average call length), this equates to a per-minute rate of $0.1455, far below Pay Tel's cost of $0.33/minute, including commissions. Similarly, other states or confinement facilities cap local calling rates based on the dominant LEC local calling rate as shown below:

State	Local Rate	Basis	Average Revenue per Minute	Pay Tel Average Cost/Min. w/ Comm'n	Profit/(Loss) per Minute
NC	$1.71	Rate Cap	$0.155	$0.33 per Minute	($0.175)
VA	$1.25	Required Rate at the Majority of VA Facilities*	$0.114		($0.216)
GA	$2.70	Rate Cap	$0.246		($0.084)
SC	$2.60	Rate Cap	$0.236		($0.094)
FL	$2.25	Required Rate at the Majority of FL Facilities*	$0.205		($0.125)

* Rate was established based on the historical local carrier rate

[14] *See* Pay Tel Ex Parte Presentation, *Inmate Calling Services Cost Presentation (Public Version)*, WC Dkt. 12-375 (July 23, 2013); Pay Tel Ex Parte Presentation, *Cost Summary*, WC Dkt. 12-375 (July 29, 2013).

[15] Pay Tel exclusively provides ICS in jails, where debit calling is less prevalent, thus the collect/prepaid call figures are the most relevant in Pay Tel's situation.

[16] *See* Technologies Management, Inc., Rates for a 15 Minute Inmate Local Collect Call With Any State-Imposed Rate Ceiling (March 13, 2013).

Based on Pay Tel's demonstrated costs as set forth in its cost study, it is clear that Pay Tel loses money under these local rate caps. Its cost of providing a 11-minute collect call is $3.63 ($0.33 X 11 minutes), far in excess of the state caps.

This problem that would be created by addressing only interstate rates is accentuated for jails, where local calls are the predominant form of calling. Pay Tel has shown that approximately 84% of its revenue generating calls are local calls, but those calls generate only 66% of total revenue. Conversely, Pay Tel's interstate calls are only 2.7% of total revenue calls yet they generate 8% of its revenue. Like other ICS providers in jails, Pay Tel has managed to survive to this point by subsidizing local calls with long distance revenues. Plainly, if the Commission were to now cap interstate rates at a level such that Pay Tel and other ICS providers were to lose this "subsidy", they would simultaneously lose their ability to operate as going concerns.[17][18]

III. The Commission Has Clear Jurisdiction Over Intrastate ICS Rates.

The Commission's jurisdiction to ensure that local rate caps do not undermine the "fair compensation" goal of the Act clear from the plain language of Section 276, as well as the Commission's own interpretation of its authority, its definition of "fair compensation", and the federal courts' construction of the statute's jurisdictional mandate.

A. The Language and Structure of the Statute Plainly Establishes the Commission's Authority Over Both Intrastate and Interstate Rates and Services.

The language and structure of Section 276 of the 1996 Act confer on the Commission plenary authority to regulate intrastate payphone calling—including local rates—and to exercise

[17] For 2012, based on audited financial statements, Pay Tel recorded only a 1.5% profit. If Pay Tel's interstate revenues are reduced without accompanying cost reductions, obviously it will be "underwater" as a whole.

[18] Adoption of the Petitioners' $0.07/minute proposal would certainly cause massive arbitrage problems in jails, with attendant loss of security as the identity and location of called parties is masked or obfuscated. Pay Tel and other providers have documented increasingly prevalent rate arbitrage in the ICS industry. *See, e.g.*, Pay Tel Reply Comments at 11 (noting that consumers who currently engage in rate arbitrage generally seek non-geographic numbers to take advantage of lower local calling rates and that imposing a low interstate rate cap would lead to rate arbitrage in "reverse"); Telmate Comments at 8, 10 (citing exponential growth in local calling from 2007 to 2012, clear evidence of jurisdictional arbitrage). Some alternative providers even expressly assist consumers in creating false "local" numbers and addresses in order to engage in such arbitrage. *See* Pay Tel's Notice of Ex Parte Presentation, WC Dkt. 12-375 (July 26, 2013). Rate arbitrage—in one "direction" or the other—will exist so long as there are disparities between intrastate and interstate rates. The Commission must regulate both, and it has the authority and responsibility to do so.

that jurisdiction to ensure that all ICS providers are fairly compensated for every intrastate call.[19] Indeed, multiple provisions of Section 276 confer jurisdiction on the Commission to regulate intrastate rates and services.

First, and most importantly, Section 276(b)(1)(A) unequivocally states that the Commission must impose surcharges and take other steps necessary to ensure that providers are compensated fairly on a call-by-call basis, for every intrastate (and interstate) call: "[T]he Commission shall take all actions necessary to prescribe regulations that establish a per call compensation plan to ensure that all [ICS] providers are fairly compensated for each and every completed intrastate and interstate call . . . ."[20]

Likewise, Section 276(b)(1)(B), which implements the subsidy prohibition of Section 276(a), expressly applies to intrastate (and interstate) services by directing the Commission to "prescribe regulations that . . . discontinue the intrastate and interstate carrier access charge payphone service elements and payments in effect on February 8, 1996, and all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues, in favor of a compensation plan as specified in subparagraph (A)."[21] The clear intrastate application of subsection (b)(1)(B) reinforces what is plain from the face of the 1996 Act: Congress intended the Commission to exercise plenary authority over both intrastate and interstate payphone calling in order to carry out the statutory mandate to eliminate subsidies and discrimination and to ensure fair compensation to providers.[22]

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[19] As a threshold issue, the Commission plainly has jurisdiction over ICS providers. *See* 47 U.S.C. § 276(d) (defining "payphone service" to include "the provision of inmate telephone service in correctional institutions").

[20] 47 U.S.C. § 276(b)(1)(A) (emphasis added).

[21] Id. § 276(b)(1)(B) (emphases added).

[22] Other subsections are to similar effect, although they do not expressly use the term "intrastate" to describe their scope as subsections (b)(1)(A) and (B) do. Sections 276(b)(1)(D) and 276(b)(1)(E) authorize the Commission to promulgate regulations governing PSPs' negotiations with carriers for intraLATA and interLATA calls. Because the vast majority of intraLATA calls (and many interLATA calls) are intrastate, subsections (b)(1)(D) and (b)(1)(E) necessarily contemplate regulation of intrastate payphone calling. Similarly, Section 276(b)(1)(C) requires the Commission to "prescribe a set of nonstructural safeguards for [BOC] payphone service to implement the provisions of paragraphs (1) and (2) of subsection (a) . . . ." Subsection (a), in turn, prohibits BOCs from subsidizing their payphone service "directly or indirectly from [their] telephone exchange service operations or [their] exchange access operations" and from "prefer[ring] or discriminat[ing] in favor of [their] payphone service." 47 U.S.C. § 276(a). Although the regulatory mandate embodied in subsection (b)(1)(C) does not use the term "intrastate," it is plain that the Commission's regulatory authority includes the authority to address both intrastate and interstate subsidies and discrimination. A contrary reading of the statute would render meaningless the clear directive to the Commission that it "discontinue . . . all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues." Id. § 276(b)(1)(B).

Should any doubt remain about the Commission's regulatory jurisdiction over intrastate ICS, subsection (c) of Section 276 removes it: "To the extent that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements."[23] Subsection (c) expressly preempts state requirements that are inconsistent with any regulations promulgated by the Commission under the authority conferred by Section 276. Existing state rate caps (or other rules), then, present no obstacle to Commission regulations promulgated pursuant to Section 276(b)(1)(A). The statute allows, and even mandates, the Commission to preempt state regulations that are inconsistent or interfere with the Commission's mandate to ensure fair compensation to ICS providers for all calls.

Taken as a whole, the governing statute's plain language unequivocally grants the Commission full statutory authority to regulate inmate calling services—specifically, intrastate rates. Indeed, it would defy logic for Congress to command the Commission to promulgate rules and "take all actions necessary . . . to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call" but leave it powerless to promulgate rules that address and ameliorate the effects of local rate caps and other elements of a payphone service provider's compensation. To construe Congress's express mandate to take "all actions necessary" and to preempt any state requirements that are inconsistent with the Commission's regulations as anything other than a broad grant of jurisdictional authority over this area subverts the plain meaning of the statute.

B. The Commission Has Declared That Its Jurisdiction Extends to Intrastate Rates and Services—and Defined "Fairly Compensated".

In keeping with the language and structure of Section 276, the Commission has consistently taken the position that Section 276 confers upon it broad authority to regulate both intrastate and interstate payphone service.[24] Congress's grant of this regulatory jurisdiction after Section 2(b) of the Communications Act means that Section 276 overrides the general limitation on jurisdiction contained in Section 2(b), 47 U.S.C. § 152(b).[25]

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[23] 47 U.S.C. § 276(c) (emphasis added)

[24] *See, e.g.*, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Order on Reconsideration, FCC 96-439, 11 FCC Rcd 21233, ¶ 162 (1996) ("Payphone Reconsideration Order") (rejecting argument that Commission lacked authority to impose rate requirements on intrastate payphone line rates: "We disagree . . . regarding our authority to require federal tariffing of payphone services . . . .").

[25] *See id.* at ¶ 57 ("In enacting Section 276 after Section 2(b), and squarely addressing the issue of interstate and intrastate jurisdiction, we find that Congress intended for Section 276 to take precedence over any contrary implications based on Section 2(b)."); *see also Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order*, 11 FCC Rcd 15499, ¶ 93 (1996) (identifying other instances where "Congress indisputably gave the Commission intrastate jurisdiction without amending Section 2(b)," such as in Sections 251(e)(1), 253, 276(b), and 276(c), and concluding that "the lack of an explicit exception in section 2(b) should not be read to require
(continued . . .)

From its own orders, then, it is clear that the Commission views Section 276 as conferring broad authority over payphones generally—and a mandate to ensure fair compensation for both inter- and intrastate calls specifically. In the Commission's own words, "Congress gave [the FCC] the requisite authority in Section 276 and directed us to adopt a comprehensive plan for payphones," including "a particular compensation plan"—even one that "contradicts existing state regulations."[26] The Commission has expressed no uncertainty about the reach of its regulatory jurisdiction or its authority to regulate intrastate payphone rates in furtherance of the clear directive of Section 276.[27]

Crucially, the Commission has previously declined to either preempt state rate caps on local collect calls, or permit ICS providers to collect an additional per-call surcharge above state rate caps, on the grounds that it believed such providers would able to recover their costs in the aggregate—n*ot* on the grounds that it lacked the authority to do so:

> [T]he critical factor is that the costs must ultimately be recovered, but we will not mandate a particular method of cost recovery. Unless an ICS provider can show that (i) revenue from its interstate or intrastate calls fails to recover, for *each* of these services, both its direct costs and some contribution to common costs, or (ii) the *overall* profitability of its payphone operations is deficient because the provider fails to recover its total costs from its aggregate revenues (including both revenues from interstate and intrastate calls), then we would see no reason to conclude that the provider has not been "fairly compensated."[28]

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an interpretation that the Commission's jurisdiction under sections 251 and 252 is limited to interstate services" because "a contrary holding would nullify several explicit grants of authority to the FCC . . . and would render parts of the statute meaningless").

[26] Payphone *Reconsideration Order*, at ¶ 57.

[27] In keeping with this view of the intrastate reach of Section 276, the Commission has stated repeatedly that its cost-based rates and new services test requirements apply to ILECs' intrastate as well as interstate rates. *See, e.g., Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Order*, DA 97-678 (Apr. 4, 1997) (cost-based new services test requirement applies to ILECs' intrastate as well as interstate rates); *Payphone Reconsideration Order*, at ¶ 163 & n.492 ("states must apply these [cost-based tariff] requirements and the *Computer III* [new services test] guidelines for tariffing such intrastate services").

Some commenters argue that the fact the Commission has rejected certain requests to preempt state rate caps or to impose federal surcharges suggests that the Commission cannot, or should not, exercise its jurisdiction in this area. *See, e.g.*, Comments of Global Tel*Link. This argument is a non-starter—the Commission's decision not to intervene in certain circumstances is in no way equivalent to a determination that it does not have the jurisdictional authority to regulate intrastate payphone rates and services.

[28] *ICS Order & NPRM*, at ¶ 23.

That the Commission has declined, thus far, to exercise its authority to adopt regulatory mechanisms reaching intrastate ICS rates is in no way an indication that the Commission lacks that authority.

C. Judicial Interpretations of Section 276 Reaffirm the Reach of the Commission's Jurisdiction

The D.C. Circuit Court of Appeals has confirmed the intrastate application of Section 276(b)(1)(A). In *Illinois Public Telecomms. Ass'n v. FCC*,[29] the appellate court considered a challenge to a Commission order deregulating intrastate local coin calling from payphones. Several petitioners urged that "the Commission lacks authority to regulate, or . . . to deregulate and prevent the States from regulating . . . rates for local coin calls."[30] The D.C. Circuit rejected that argument, concluding that the clear statutory language of Section 276 "unambiguously grants the Commission authority to regulate the rates for" intrastate payphone calls.[31] As *IPTA* suggests, there is no argument—either based in the text of the statute or derived from judicial interpretation of the statutory language—that the fair compensation provision does not apply to all PSPs, to all intrastate and interstate ICS calls.

In *New* England Public Communications Council v. FCC,[32] the D.C. Circuit concluded that the 1996 Act "authorizes the Commission to regulate BOC intrastate payphone line rates, but not those of non-BOC local exchange carriers." At issue in *New England Public Communications Council* was whether the Commission, in an effort to carry out the statutory mandate to preclude discrimination by BOCs, properly ordered BOCs to price intrastate service lines used by competing PSPs at forward-looking, cost-based rates. Based on the clear language of the statute, the court concluded that "section 276 unambiguously and straightforwardly authorizes the Commission to regulate the BOC's intrastate payphone line rates."[33] The court rejected the argument that the Commission's prescribed ratemaking methodology applied equally to non-BOC LECs, but it addressed the Commission's authority to regulate under subsections (a) and (b)(1)(C), which "expressly apply only to the BOCs."[34] Subsection (b)(1)(A) is not so limited.

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[29] 117 F.3d 555 (D.C. Cir. 1997) (per curiam), *cert. denied sub nom. Virginia State Corporation Comm'n v. FCC*, 523 U.S. 1046 (1998) ("IPTA").

[30] 117 F.3d at 561.

[31] *Id.* at 562; *see also id.* at 563 ("the Commission has been given an express mandate to preempt State regulation of local coin calls") (emphasis added).

[32] 334 F.3d 69, 71 (D.C. Cir. 2003).

[33] *Id.* at 75.

[34] *Id.* at 78-79.

The rationale the D.C. Circuit applied to conclude that the Commission's jurisdiction extended to BOC (but not to non-BOC LEC) payphone rates in *New England Public Communications Council* in fact confirms that the Commission's jurisdiction extends to the regulation of inter- and intrastate rates (and per-call surcharges, other ancillary fees, and even commissions arrangements—in other words, regulation of all relevant elements of compensation) to ensure that ICS providers receive fair compensation "for each and every completed intrastate and interstate call." The D.C. Circuit reasoned that "it would make little sense for Congress to command the Commission to promulgate rules opening the payphone market to competition while leaving it powerless to address intrastate subsidies and discrimination, which are, after all, no less an obstacle to fair competition than interstate subsidies and discrimination."[35]

IV. The Commission Must Preempt And/Or Otherwise Regulate Intrastate ICS Rates In Order To Comply With Federal Law And Fulfill Its Mandate.

Pay Tel has demonstrated that it does not recover its costs on many local calls because Pay Tel's costs exceed the rates at which such calls are capped in several of the states in which Pay Tel provides ICS. As such, Pay Tel is "fairly compensated" for these calls, in the aggregate, due only to the "cross-subsidization" of interstate ICS calls. Because of that cross-subsidization, Pay Tel is currently able to "ultimately recover its costs".

This would not be the case, however, if the Commission were to regulate interstate rates and leave intrastate rates untouched in such a manner as to "cancel out" the interstate rates' cross-subsidization effect. Such Commission action would undeniably result in an ICS industry wherein Pay Tel's "overall profitability" would be deficient because it would be unable to recover its total costs from its aggregate revenues.

Commission action (or inaction) leaving Pay Tel and other ICS providers in that unprofitable position would unquestionably contravene and fail to meet the Commission's expressly stated standard for "fair compensation". Such action or inaction would therefore clearly violate the federal mandate of Section 276. The plain language of that section, along with Commission and judicial precedent, permit the Commission to preempt and otherwise regulate intrastate ICS rates.

Pay Tel has demonstrated through its cost study that the issue here goes beyond whether the Commission is merely "permitted" to intervene in intrastate ICS rates. Indeed, the Commission must act. Pay Tel and other providers in jails will be unable to continue as going concerns if the Commission takes a hands-off approach to intrastate rates. The Commission cannot do this. The law requires "fair compensation". The Commission must exercise its authority and regulate intrastate ICS rates to ensure providers receive that which the law requires.

[35] *Id.* at 77.

V. The NPRM Gives Fair Notice That Intrastate Rates and Ancillary Fees Are In Issue.

In the NPRM, the Commission grants two longstanding petitions for rulemaking filed in 2003 and 2007 seeking to "secure the 'just and reasonable' interstate rates for prisons required by Section 201(b) of the Communications Act".[36] In short, the Notice seeks to consider changes to the Commission's rules governing rates for interstate interexchange ICS. *See* NPRM, at ¶ 1. That said, the breadth of the NPRM makes clear that, in light of overwhelming policy considerations and length of time that these issues have been under consideration at the Commission, the Commission is undertaking a broad review and potential rulemaking with respect to ICS rates: "In the interest of developing a complete and current record, this Notice seeks comment on the reasonableness of current ICS rates and what steps the Commission can and should take to ensure reasonable ICS rates going forward." NPRM, at ¶ 8.

In response to the Commission's broad invitation for comments on its jurisdiction over ICS interstate and intrastate rates, as well as comments on particular proposals or possible alternatives for ensuring just and reasonable ICS rates, the record is replete with comments from ICS providers, inmate advocacy groups, consumers, and others as to how the Commission should analyze and address this complex question.

Under Section 553(b) of the Administrative Procedure Act, an agency must provide notice that includes:

> (1) a statement of the time, place, and nature of public rule making proceedings;
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> (2) reference to the legal authority under which the rules is proposed; and
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> (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

5 U.S.C. § 553(b).

Courts have generally interpreted the notice requirement to mean that a final rule adopted by an agency must be a "logical outgrowth" of the proposed rule. *See, e.g.*, *South Terminal v. EPA*, 504 F.2d 646 (1st Cir. 1974); *see also Small Refiner Lead Phase-Down Task Force v. EPA*,

[36] *See* Implementation of the Pay Telephone Reclassification Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Petition of Martha Wright et al. for Rulemaking or, in the Alternative, Petition to Address Referral Issues in Pending Rulemaking, CC Docket No. 96-128 (filed Nov. 3, 2003) ("First Wright Petition"); *see also* Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Petitioners' Alternative Rulemaking Proposal, CC Docket No. 96-128, at 4-6 (filed Mar. 1, 2007) ("Alternative Wright Petition").

705 F.2d 506, 547 (D.C. Cir. 1983) (agency's final rule must only be a "logical outgrowth" of its proposed rule); *cf. Exxon Corp. v. Fed. Energy Admin.*, 398 F. Supp. 865, 880 (D.D.C. 1975) (when discussion during a public hearing "should have been obvious to all participants" that the agency was concerned about a particular question, "actual notice" of subjects and issues involved has been provided even though notice of rulemaking "simply fail[ed] to indicate" an important subject).

Courts have explained that the logical outgrowth threshold is met so long as a "germ" of the final rule is included in the agency's original proposal. *See NRDC v. Thomas*, 838 F.2d 1224, 1243 (D.C. Cir. 1988). An agency "can obviously promulgate a final regulation that differs in some respects from its proposed regulation" because " 'a contrary rule would lead to the absurdity that . . . the agency can learn from the comments on its proposals only at the peril of starting a new procedural round of commentary.' " *Id.* at 1242 (quoting *Int'l Harvester Co. v. Ruckelshaus*, 155 U.S. App. D.C. 411, 478 F.2d 615, 632 n.51 (D.C. Cir. 1973). Indeed, " '[t]he whole rationale of notice and comment rests on the expectation that the final rules will be somewhat different – and improved – from the rules originally proposed by the agency.' " *City of Stoughton v.* EPA, 858 F.2d 747, 753 (D.C. Cir. 1988) (quotation omitted). Moreover, simply because a party disagrees in its comments with an agency's final rule does not mean that notice was inadequate, but merely that the agency did not agree with a party's comments. *See id.*

Under the notice requirements of the APA, there can be no doubt that the NPRM addresses "either the terms or substance of the proposed rule or a description of the subjects and issues involved" with respect to the issues relevant here. 5 U.S.C. § 553(b). The topics—preemption by the Commission of intrastate ICS rates and the Commission's potential assumption of jurisdiction over ancillary fees—are addressed both explicitly in the NPRM and through ample vetting during the public comment period such that both issues are a "logical outgrowth" of the NPRM.

A. The NPRM Provides Actual Notice With Regards to Both Intrastate Rates and Ancillary Fees.

First: On the possibility of preemption by the Commission of intrastate ICS, the NPRM explicitly raises the subject several times when seeking comment on how the Commission should tackle interstate ICS rates and whether intrastate ICS rate regulation should be part of that analysis. For example, the Commission seeks comment on:

- Whether ICS regulation is "exclusively a state issue" or whether the Commission should be involved. *See id.* at ¶ 52 ("How would [the view that ICS regulation be left to state correctional officials] be reconciled with the Commission's obligations under sections 201 and 276 and the fact that the question of the reasonableness of ICS rates was referred to the Commission under the doctrine of primary jurisdiction? Would the Commission's fulfillment of its obligations under sections 201 and 276 potentially result in preemption of states' exercise of regulatory or police power authority?").

- Whether and how to address intrastate-interstate parity of ICS rates. *See* NPRM, at ¶ 34 ("To the extent that interstate rates for inmate calling services are significantly higher than intrastate rates, how would a requirement that ICS providers set interstate rates at a level no higher than intrastate, long-distance rates affect the justness and reasonableness of those rates? How many states set rates specifically for ICS? What is the rate structure for ICS calls in those states, and what are the rates for intrastate, long-distance calls? How do states that set specific ICS rates ensure that ICS providers are "fairly compensated?) (footnotes omitted);

- The Commission's legal authority to regulate ICS. *See id.* at ¶ 49 ("We seek comment on the scope of the Commission's legal authority to regulate ICS. . . We encourage commenters to discuss additional sources of legal authority for the Commission to address ICS rates.") (footnotes omitted); *id*. at ¶ 50 ("Many calls made from correctional facilities are intrastate local or long distance calls, which are regulated by the states. We therefore seek comment on how the Commission can encourage states to reevaluate their policies regarding intrastate ICS rates.").

Second: The NPRM provides actual notice of the Commission's possible assumption of jurisdiction over ancillary fees, as such fees must be considered in any complete analysis of the elements affecting ICS rates. Specifically, the Notice asks:

- How ancillary fees should be handled if prepaid calling is implemented as an alternative to collect and debit calling. *See id.* at ¶ 33. ("Commenters argue that the benefits of [prepaid calling] may include administrative ease for the providers, increased safety, controlled costs for call recipients, and eliminating the need to block calls because of a call recipients' credit standing. However, Petitioners note that there are outstanding questions with prepaid calling such as: how to handle monthly fees; how to load an inmate's account; and minimum required account balance. If these issues can be sufficiently addressed, is prepaid calling a viable ICS option? . . . What are some other concerns or considerations with prepaid calling?").

- For data to help the Commission set ICS rates should it decide to implement rate caps. *See id.* at ¶ 23 ("If the Commission decides to implement rate caps in the ICS market how should we? What additional data, if any, does the Commission require to set rates? . . .We seek comment on the best ways to determine just and reasonable caps for ICS rates.");

- Whether the ICS Provider Proposal methodology would result in a just and reasonable rate. *See id.* at ¶ 25 ("We . . . encourage commenting parties that disagree with the ICS Provider Proposal or proposed methodology to provide alternative methodologies supported by sufficiently-detailed data.").

In short, though the impetus behind the present NPRM is two petitions centered on securing just and reasonable interstate interexchange ICS rates for prisoners, the Commission's Notice seeks broader comment in order to effect a meaningful result in the area of ICS rates. Through the topics explicitly enumerated above and also through the Notice's general appeal for "comment on any new issues that have arisen in the ICS market or issues that have not been addressed" in the discussion of proposals under consideration, the Commission provides notice that a final rule will take a holistic approach to addressing ICS. *Id*. at ¶ 47.

B. The Comment And Reply Period Demonstrates A Logical Outgrowth Of Potential Rulemaking.

Although the Notice itself provides adequate notice of rulemaking each of the topics, the record developed through the comment period likewise makes clear that any such rulemaking is a logical outgrowth of the Commission's Notice.

1. The Comments Reflect Notice To The Public Of The Issues.

First: The comments and replies of numerous parties demonstrate the Commission's notice of potential rulemaking involving the Commission's preemption of intrastate rates. For example:

- Comments of Martha Wright, et al. ("Wright Petitioners"), WC Docket 12-375, at 6 (Mar. 25, 2013) ("Congress granted the FCC explicit authority to regulate ICS under Section 276 of the Act. Section 276 directs the FCC to "establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every intrastate and interstate call. . . .");

- Comments of Michael S. Hamden ("Hamden"), WC Docket 12-375, at 5 (Mar. 25, 2013) ("Section 276 also extends the Commission's authority over intrastate rates, in addition to interstate rates.");

- Reply Comments of Hamden, WC Docket 12-375, at 5 (Apr. 22, 2013) ("[I]f the Commission establishes a 'just and reasonable' benchmark rate for both intrastate and interstate calls that allows ICS providers to seek adjustments from state utilities regulatory agencies upon a showing of abnormally high service costs at a particular locale, any legitimate dispute about possible justifications for cost disparities becomes academic.");

- National Association of State Utility Consumer Advocates ("NASUCA") Reply, WC Docket 12-375, at 2 (Apr. 18, 2013) (Section 276 "gives the Commission plenary authority over ICS calling, both interstate and intrastate.");

- Comments of Securus Technologies, Inc. ("Securus"), WC Docket 12-375, at 8–15 (Mar. 25, 2013) (arguing that Commission does not have jurisdiction over correctional facilities operations and may only intercede in service rates where a market failure is demonstrated);

- Comments of Pay Tel Communications, Inc. ("Pay Tel"), WC Docket 12-375, at 3 (Mar. 25, 2013) ("To the extent reform efforts are undertaken, they must be comprehensive, considering all aspects of local and non-local, intrastate and interstate calls at both prisons and jails, which have radically different calling environments."); *id*. at 9 ("[E]stablishing benchmarks for interstate rates necessarily requires reviewing the current costs and revenue structure of intrastate calls. Appropriately, the Commission must set rates for below cost intrastate rates that fairly compensate ICS providers."); *see also* Pay Tel Reply, WC Docket 12-375, at 13–14 ("Any proper view of, or approach to, the ICS industry necessarily must take into account all calls, both interstate and intrastate.")

Second: With respect to the potential FCC assumption of jurisdiction over ancillary fees, the comments and replies make clear that the public is on notice that the Commission may issue a final rule in this area:

- Wright Petitioners Comments, at 26 ("[T]he FCC must find that the ancillary fees imposed on ICS customers are unjust and unreasonable. Such fees add to the effective price of inmate calls and are not related to the cost of providing the service."); *see also* Wright Petitioners Reply, at 1;

- Reply Comments of Telmate, LLC ("Telmate"), at 7 (Apr. 22, 2013) ("The Commission should also reject the suggestion that, in connection with the proposed $0.07/min. cap, it prohibit or exclude any "ancillary" fees, including site commissions.");

- Hamden Comments, at 8 ("The FCC's legal authority to regulate or prohibit these ancillary charges is as certain and expansive as it is for other aspects of ICS practices.");

- [Pay Tel Comments, at 15 (enumerating ancillary fees such as payment processing fees, bill processing fees, direct billing cost recovery fees, validation surcharges, wireless administration fees, universal service administration fees, other service-specific service charges, local non-subscriber charges, and carrier cost recovery fees that must be addressed by the FCC during this rulemaking);]

2. Notice Requirements Are Met Even If Parties Disagree With Commission.

As described above, in light of the Commission's broad invitation for comments in the ICS rate area, as well as the numerous particular requests for comment, the NPRM more than sufficiently meets the APA's notice requirements. The *South Terminal*, 504 F.2d at 646, case is instructive. There, several petitioners claimed that the Environmental Protection Agency's ("EPA") Metropolitan Boston Air Quality Transportation Control Plan "differed so radically" from the EPA's proposed notice that "they had no meaningful forewarning of its substance." *Id*. at 656.

The Sixth Circuit reviewed the rulemaking at issue, which included a final plan that differed from the original proposal and was heavily influenced by the public hearing and comment process. The court noted that, "[a]lthough the changes were substantial, they were in character with the original scheme and were additionally foreshadowed in proposals and comments advanced during the rulemaking. Parties had been warned that strategies might be modified in light of their suggestions." *Id*. at 658. For example, the EPA Administrator had " 'particularly invited [comments] pertaining to the other measures that may be taken by Federal, State, or local authorities to support or supplement the proposed air pollution control measures. . . .[and noted that the final rule would] be influenced by the comments and testimony" received throughout the rulemaking process.' " *Id*. (citation to Federal Register omitted). The court concluded that "interested persons were sufficiently alerted to likely alternatives to have known what was at stake" and that the final plan was a "logical outgrowth of the hearing and related procedures." *Id*. at 659.

The NPRM here is similar to the notice in *South Terminal*. The Notice seeks comments and alternatives to addressing the interstate interexchange ICS issue, thus foreshadowing that a final rule might include any number of alternatives that arise during the comment period. *See, e.g.*, NPRM, at ¶ 8 ("In the interest of developing a complete and current record, this Notice seeks comment on the reasonableness of current ICS rates and what steps the Commission can and should take to ensure reasonable ICS rates going forward.); *id*. at ¶ 47 ("We encourage comment on any new issues that have arisen in the ICS market or issues that have not been addressed above."); *id*. at ¶ 49 ("We encourage commenters to discuss additional sources of legal authority for the Commission to address ICS rates.").

In addition, any argument that the commenting parties disagree as to the merits of these topics and therefore notice is insufficient fails. As discussed above, the courts are clear that a divergence between a proposed rule and final rule is to be expected through the rulemaking process. Under the logical outgrowth rule, the goal of the notice requirements – *i.e.*, fair notice – is more than amply satisfied with respect to the two issues. *See Leyse v. Clear Channel Broadcasting, Inc.*, 697 F.3d 360 (6th Cir. 2012). Moreover, simply because a party may disagree in its comments with the Commission's potential action does not mean that notice is insufficient – indeed, it establishes the opposite, *i.e.*, "comments that address the issue resolved in the Final Rule provide evidence that the notice was adequate." *Id.*

For example, in *City of Stoughton*, the D.C. Circuit rejected the petitioner's argument that further notice was required when the agency reviewed public comments, including a consultant's information between the publication of the proposed rule and the final rule, and changed its theory after the comment period without allowing petitioner another opportunity to comment. The court emphasized that the APA's notice requirement does not mandate a new opportunity for comment each time an agency reacts to public comments, and that the petitioner's problem was "not that it could not make comments but simply that the [agency] did not agree with its comments." *City of Stoughton*, 858 F.2d at 753.

Based on the comments in the record, there can be no question that the Commission has provided adequate notice as to the two issues related to intrastate rates and ancillary fees. For example, even if one party disagrees as to the Commission's jurisdiction or notice of an issue, *see, e.g.*, Securus Reply, at 14–16 (arguing that ancillary fees are outside the scope of the proceeding and the Commission's jurisdiction and notice not given), the public comments demonstrate otherwise. In short, though parties may disagree as to the limits of the Commission's jurisdiction or the appropriate approaches, the public has been provided adequate notice of potential rulemaking on the two issues, and they are each a logical outgrowth of the NPRM.

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